

General Information Letter: Prior to the enactment of Public Act 91-541, no subtraction modification is allowed for deductions disallowed under Section 280C of the Internal Revenue Code.

February 16, 2000

Dear:

This is in response to your letter dated February 3, 2000, in which you request a letter ruling. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter you have stated the following:

We are responding on behalf of the above mentioned taxpayer to your Notice of Balance Due dated February 13, 2000 (copy enclosed). We believe that the "Other Subtractions" claimed by the taxpayer of \$530,200 were improperly reduced to zero.

The taxpayer is involved in the restaurant business. Its employees, who help service the taxpayer's restaurants, receive tip income. The taxpayer is required to remit the employer's portion for payroll taxes on this tip income. The subtractions claimed by the taxpayer on line 5f of the Illinois Form 1120 represented an economic outlay paid by the taxpayer in the form of payroll taxes. Under Section 45B of the Internal Revenue Code (the "Code"), an employer may claim a credit (the "Federal Tip Credit") equal to the "excess social security tax" paid or incurred by the taxpayer during the taxable year. In general, the excess social security tax means any tax paid under Section 3111 of the Code with respect to tips: (1) received by an employee to the extent such tips are deemed paid by the employer to the employee and, (2) exceed the amount by which the wages (excluding tips) paid to the employee are less than the applicable minimum wage rate. In addition, the only tips received from providing, delivering, or serving food or beverages are taken into account.

Importantly, for federal tax purposes, a taxpayer may not take a deduction for any amount taken into account in determining the Federal Tip Credit. As a result, the taxpayer reduced its payroll tax deduction which had the effect of artificially increasing its federal taxable income. The Federal Tip Credit then served as a reduction in the final calculation of taxes due by the taxpayer. For federal tax purposes, the taxpayer received a greater benefit by claiming the Federal Tip Credit than by claiming a payroll tax deduction.

The starting point for calculating an Illinois corporate taxpayer's base income is its federal taxable income. Since the taxpayer's federal taxable income was artificially inflated, it was necessary for the taxpayer to subtract the portion of its payroll taxes paid which were not deducted for federal tax purposes. By reducing the "Other Subtractions" of \$530,200 to zero, the taxpayer is unfairly denied a deduction for an economic outlay (i.e., payroll taxes) that Illinois recognizes as an ordinary and necessary business expense.

We respectfully request that the taxpayer's account be adjusted accordingly to reinstate the \$530,200 deduction as an acceptable item in "Other Subtractions." We also respectfully request that all interest and penalties assessed in connection with this matter be abated.

Response

As you noted in your request, your client claimed a credit under Section 45A of the Internal Revenue Code. The information attached to your request shows that your client also claimed a Jobs Tax Credit under Section 51 of the Internal Revenue Code. Section 280C(a) of the Internal Revenue Code denies a deduction for wages paid or incurred equal to the amount of each of these credits.

Section 203(b)(1) of the Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 et seq.) provides that the computation of a corporation's base income begins with that corporation's federal taxable income. Various addition and subtraction modifications are then made under Section 203(b)(2) of the IITA. For the taxable year of xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx ending January 3, 1999, none of the subtraction modifications listed in that section could be construed to allow a subtraction for a wage deduction denied under Section 280C of the Internal Revenue Code.

Section 203(h) of the IITA provides:

Except as expressly provided by this Section there shall be no modifications or limitations on the amounts of income, gain, loss or deduction taken into account in determining gross income, adjusted gross income or taxable income for federal income tax purposes for the taxable year, or in the amount of such items entering into the computation of base income and net income under this Act for such taxable year, whether in respect of property values as of August 1, 1969 or otherwise.

Accordingly, no subtraction modification can be allowed for wages whose deduction was disallowed under Section 280C of the Internal Revenue Code.

Please note that, for taxable years ending on or after August 13, 1999, Public Act 91-541 amended Section 203(b)(2)(I) of the IITA to allow a subtraction modification for all deductions disallowed under Section 280C of the Internal Revenue Code. However, this amendment does not allow the subtraction for your client for its taxable year ended January 3, 1999.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Sincerely,

Paul S. Caselton
Deputy Chief Counsel -- Income Tax